WHITE & CASE

Financial Regulatory Observer

The Financial Regulatory Observer regularly sets spotlights on selected topics driving the regulatory and technological changes in the financial industry.

December 2018

Road to Brexit: Explaining the process toward a deal/no deal

As the Withdrawal Agreement is pending in Parliament, the effects of Brexit remain unclear.

Negotiation process

Article 50 TEU sets out three cumulative requirements for an orderly withdrawal from the EU: a unilateral notification of withdrawal; a withdrawal agreement (WA); and a framework for the EU-UK future relationship. The UK fulfilled the first requirement on 29 March 2017 when it formally notified the European Council of its intention to withdraw from the EU. The second and the third requirement, however, are not yet fulfilled. Even though the EU and the UK reached a draft WA on the negotiators' level on 14 November 2018, it remains to be seen whether this draft WA will be accepted by the House of Commons. On 14 November 2018 a draft political declaration on a future framework was concluded by the EU and the UK as well. This draft declaration was specified a couple of days later on 22 November 2018.

Withdrawal Agreement

The WA, the second requirement, is set to be an international treaty between the EU and the UK comprising good faith commitments, which are legally binding on both parties under international law. The final version must include a transition agreement and, in a separate political declaration, commitments to finalizing a treaty on the future relationship between the EU and the UK after Brexit day.

The EU and the UK started to negotiate the WA on 19 June 2017. During the first phase of negotiations, they discussed issues in relation to citizens' rights, financial settlement and the Ireland/Northern Ireland border. As a result of the first phase, they released the Draft Agreement on the withdrawal of the UK from the EU and European Atomic Energy Community on 28 February 2018, including a protocol on Ireland/Northern Ireland.

On 14 November 2018, the EU and the UK agreed on a 585 page-long draft WA on the negotiators' level. The draft WA covers the issues mentioned above as well as provisions to safeguard the circulation of goods already placed on the market on 29 March 2019. It does not contain any detailed provisions on financial services whatsoever.

Transition period

In Art. 126 of the WA, a transition period is stipulated. This period would run from Brexit day to 31 December 2020. During this time, EU law and jurisprudence would continue to apply to the UK as if it were an EU Member State; but being a third country, the UK would no longer participate in the EU institutions or have any voting rights. During the transition period, it is also envisaged that the UK will remain in the EU Single Market, the EU Customs Union and within the jurisdiction of the Court of the European Union. After the transition period, the UK would be free of all EU obligations and able to adopt its own trade deals with other countries. In addition, according to Art. 132 of the draft WA, this transition period might also be extended for at least one year—a provision that remained widely unnoticed.

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End of Brexit transition period

Ratifying the WA

The EU can only adopt the WA, while considering the future framework declaration, if the Council of the EU and the European Parliament give their consent. The Members of the European Parliament, including the MEPs from the UK, have to vote with a simple majority. Then, the WA has to pass the Council with a strong qualified majority, without the UK being allowed to vote (Article 238(3)b TEU). In principle, the WA does not require ratification

> "The EU and the UK must still negotiate a framework for their future relationship

“Whether or not there will be a deal, 29 March 2019 11pm GMT is the point of no return; from that moment on, the UK will no longer be a member of the EU

by the remaining Member States.

On 25 November 2018, the European Council endorsed the draft WA. Thus, it is now the UK's turn to take further steps, namely approving the draft WA in the House of Commons on 11 December 2018. If the House of Commons accepts the draft WA, the European Council could agree formally on the then finalized WA at its 13 and 14 December 2018 meeting.

However, if the House of Commons blocks the ratification, an emergency session would need to be held. Consequently, there might be renegotiations at the European Council Meeting on 13 and 14 December 2018, followed by a second vote in the House of Commons on a renegotiated WA at the European Council Meeting.

In case no deal has been reached by the end of 21 January 2019, the UK Parliament will then discuss next steps, contingency measures or seek an extension to the Article 50 TEU process. If Parliament approves, the UK then has to pass the Withdrawal Bill (see below for further detail) to implement the WA into domestic law. After the WA has been signed, it has to be presented before both Houses for a period of 21 sitting days, as required by the Constitutional Reform and Governance Act 2010, before it may be ratified.

By ratifying the treaty, the parties give their consent to be bound in accordance with international law. The ratified WA will enter into force on Brexit day, and the transition period will start.

Future framework

The EU and the UK are still negotiating the third withdrawal requirement: a framework for their future relationship. Although it merely constitutes a political act, the framework has to be agreed to alongside the WA to ensure an orderly withdrawal. Once the UK has left the EU, the parties will have to negotiate an actual treaty in accordance with the process used to reach agreements with third countries outlined in Article 218(3) TFEU. On 22 November 2018, the EU and the UK issued a specified political declaration setting out the future framework of the relationship between them. Their aim is to conclude a Free Trade Agreement that would liberalize trade in services well beyond WTO commitments and build on recent Free Trade Agreements of the EU, such as CETA. Regarding financial services, the political declaration outlines the parties' intent to establish an equivalence regime, which would, however, be framed by their regulatory and decision-making autonomy. As the UK rejects membership in the European Economic Area, such as Norway or Liechtenstein, it would thus be under a future framework agreement, a third country to the EU.

Further, the EU and the UK intend to assess each others' regulatory framework until June 2020 in order to prepare an equivalence regime taking effect in January 2021.

By now 100% of the Withdrawal Agreement has been negotiated—now pending parliamentary approval

UK Brexit legislation

To prepare for post-Brexit, the UK Parliament passed the EU (Withdrawal) Act 2018 on 26 June 2018. The Act repeals the 1972 European Communities Act (ECA), but is without prejudice to the outcome of the negotiations. On 29 March 2019, the Act will convert all EU law in force at that date and applicable to the UK into a new domestic legal category called "retained EU law". This category preserves the rights in EU treaties on which individuals can directly rely in court, as well as all laws made in the UK to implement EU obligations. Ultimately, from the UK perspective, this process "freezes" EU law in time. To circumvent the likely disadvantages caused by applying a static body of EU law, the UK authorities will assume the competencies of the EU institutions, and after 29 March 2019 ministers will be able to amend or remove retained EU law where necessary.

If a WA is reached, the UK will need to delay the Act's key effects to ensure the continued application of EU law during the transition period. To that extent, it is envisaged that the UK Parliament would pass the transitional EU (Withdrawal

Agreement and Implementation) Bill before ratification of the WA. The Bill would delay Union law from turning into "retained EU law" and preserve the necessary parts of the ECA during the transition period. It would also implement the WA into UK law and prolong the period for the UK to apply correcting powers to EU legislation until 31 December 2022 to ensure a coherent and functioning UK statute book. The Bill would sunset at the end of the transition period, giving the Act full effect.

Brexit

Whether or not there will be a deal, 29 March 2019 11 p.m. GMT is the point of no return; from that moment onward, the UK will no longer be an EU Member State.

As matters currently stand, if the UK and the EU have not ratified the WA by that date, the UK on the one hand and the EU Member States on the other will immediately become third countries with respect to each other.

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FCA delivers verdict on EU benchmark rules

In July, the UK's Financial Conduct Authority (FCA) finalised changes to its Handbook that brought it into line with the EU Benchmarks Regulation (BMR).

Described as the regulation "on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds", BMR came into force on 30 June 2016, with most of its provisions taking effect on 1 January 2018. Its aim is to introduce a common framework and consistent approach to benchmark regulation across the EU.

While the FCA changes are not significant and do not affect the trading or negotiation of derivatives or loan facilities, it is important to monitor them and track where we are in terms of BMR implementation.

The changes remove domestic rules that are superseded by the BMR, though the FCA advised that they will continue to apply to entities which administrate or submit to benchmarks already regulated by the FCA until they are authorised or registered under the BMR.

The FCA proposes to maintain some domestic rules on benchmark administrators in areas not covered by the BMR. This process involved a two-fold consultation process on the proposed changes, Consultation Paper CP17/17 and Consultation Paper CP18/5.

These changes are not required in other EU Member States since the UK is one of the few Member States that already has a system of regulating benchmarks. The system was introduced in the UK by amendments to the Financial Services and Markets Act 2000 (FSMA), originally applying only to LIBOR in 2013, but has since been extended to a further seven benchmarks.

Currently, the FCA supervises eight "specified benchmarks", while the BMR applies much more widely, including all indices that are used in the EU as the basis for financial instruments or certain financial contracts, or that are referenced by an investment fund. As a consequence, many firms that are not currently supervised by the FCA will need to apply to the FCA for authorisation or registration under the BMR.

The BMR is directly applicable and will supersede most of the Handbook rules that deal specifically with benchmark administration and contribution. In particular, much of the benchmarks section of the Market Conduct sourcebook (MAR 8) will be deleted or amended. These changes, which took effect on 1 January 2018, give additional powers to the FCA over authorised persons that breach the BMR. More importantly, it provides for a specific registration and authorisation procedure of EU benchmark administrators.

On 29 June, the FCA published the Benchmarks Regulation (Amendment) Instrument 2018 (the "BMR Instrument") which implements the proposed changes discussed in both consultation papers. Most of the BMR Instrument came into force on 29 June 2018, other than Annex J which came into force on 1 July 2018.

As a result, administering a benchmark has become a regulated activity and essentially will involve acting as the administrator of a benchmark as defined in article 3.1(3) of BMR. The FCA has clarified that the activity of administering a regulated benchmark will always be regarded as being conducted as "by way of business" and that a firm must apply under the BMR according to where its registered office is located.

New benchmark activities include either (a) the regulated activity of administering a benchmark; or (b)

1 Jan 2018

BMR provisions took effect.

> **Many firms that are not currently supervised by the FCA will need to apply to the FCA for authorisation or registration under the BMR**

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Administering a benchmark has become a regulated activity and essentially will involve acting as the administrator of a benchmark

contributing input data to a BMR benchmark administrator. However, it is important to highlight that neither acting as a benchmark contributor nor contributing input data is a regulated activity.

Third-country benchmark contributor

A benchmark contributor will include both a third-country benchmark contributor and a UK benchmark contributor. A third-country benchmark is defined as a firm which (a) contributes input data to a BMR benchmark administrator, (b) is located in a non-EU state and (c) is either a supervised entity or would be a supervised entity if it were located in the EU. This follows the same approach that has been adopted with other regulatory frameworks, mainly EMIR.

Publication of FCA decisions

Article 34 of the BMR requires the administrator of a benchmark to be authorised or registered. The BMR Instrument makes no distinction between authorisation or registration. Firms already subject to supervision under EU legislation will apply for registration. On the contrary, firms not subject to supervision should apply for authorisation. Therefore, an important aspect for users of benchmarks is to ensure the relevant administrators are authorised or registered. During the consultation it became clear that a big concern for users was to know well in advance if a request for authorisation or registration had been refused. Although refusals for endorsement and recognition have different consequences, the same approach will be followed.

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Europe's expanding AML remit

Anti-money laundering policy and regulation continue to evolve in the European Union, but the reality of central federal authority remains some way off.

The European Commission has proposed new initiatives to further harmonise anti-money laundering (AML) supervision in the EU, although it is unclear whether these proposals will still come into force before the European elections next year. We expect to see further legislative attempts at increased European harmonisation in this field, although it seems unlikely that one central European anti-money laundering agency will be introduced in the short term.

The Fifth AML Directive, which came into force on 9 July 2018, was a response to recent terrorist attacks across the EU and the offshore leaks investigated in the Panama papers. EU Member States have until January 2020 to implement the directive into national law.

The Directive introduced four key changes to the AML regime:

- Member States should ensure that registers of ultimate beneficial owners of companies and other legal entities become accessible to the general public (but not the register of ultimate beneficial owners of trusts, which will still require demonstration of a legitimate interest)
- The AML regime is extended to cover additional service providers such as electronic wallet providers, virtual currency exchange service providers and art dealers. Further specifications regarding the scope of application of the Fifth AML Directive with respect to tax advisors and estate agents are provided;
- The threshold for identifying holders of prepaid cards is lowered to €150
- Member States will have to implement enhanced due diligence measures to monitor suspicious transactions involving high-risk countries more strictly

December 2020

The deadline for EU Member States to implement the Sixth AML Directive into national laws

The Fifth AML Directive also includes the following measures:

- Registries of politically exposed persons (PEPs): Member States are required to issue and keep an up-to-date list indicating prominent public functions for identification purposes. The Commission will compile a single list of all prominent public functions (based on the information received from the Member States, and also including the prominent public functions at EU level) and make this list public
- Centralised bank account registries: The Fifth AML Directive obliges Member States to establish centralised national bank account registries or electronic data retrieval systems, which allow for identification of every natural or legal person holding or controlling payment and bank accounts or safe-deposit boxes held by a credit institution within their territory. National competent authorities should have unrestricted access to this information in order to perform their duties under the AML Directive.

Towards the Sixth Directive

On 12 November 2018, the Sixth AML Directive was published in the official Journal of the EU. This directive aims to combat money laundering with the use of criminal law and enables more efficient and swifter cross-border cooperation between Member States. The Sixth AML Directive will need to be transposed into national law by 3 December 2020.

The Sixth AML Directive includes the following important changes:

- Introduction of a unified list of predicate offences: The definition of criminal activities that constitute predicate offences for money laundering should be sufficiently uniform in all Member States.

> "It seems unlikely that one central European anti-money laundering agency will be introduced any time soon

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Fighting effectively against financial crime, including tax crime, requires a proper implementation of the new rules and a stronger coordination between authorities

Member States should ensure that all offences that are punishable by a term of imprisonment to be out in the draft directive are considered predicate offences for money laundering. In addition, the draft directive includes a list of 22 offences that must be considered as predicate offences. It is noteworthy that in the European parliament draft this list includes "tax crimes relating to direct and indirect taxes, as laid down in national law".

- Criminal liability for organisation: The draft directive requires the extension of criminal liability for money laundering to organisations. Legal persons can be held liable where there is a lack of supervision. Member States must have in place effective, proportionate and dissuasive sanctions, such as the temporary or permanent exclusion from access to public funding, including tender procedures, grants and concessions, the temporary or permanent disqualification from the practice of commercial activities, placing under judicial supervision, a judicial winding-up order or a permanent and temporary closure of establishments that have been used for committing the offence. It will thus become of vital importance for financial institutions to strengthen their governance and oversight arrangements.
- Increased international cooperation: According to the draft directive, a Member State shall inform the Commission where it decides to extend its jurisdiction to money laundering offences that have been committed outside its territory where (a) the offender is a habitual resident on its territory; and (b) the offence is committed for the benefit of a legal person established on its territory. Where a money laundering offence falls within the jurisdiction of more than one Member State and where any of the Member States concerned can validly prosecute on the basis of the same facts, the Member States concerned shall cooperate in order to decide which of them will prosecute the offender, with the aim of centralising proceedings in a single Member State.

Stronger frameworks

Following recent incidents, the European Commission (EC) reviewed the effectiveness of the supervisory architecture and invited the chairpersons of the European Supervisory Authorities (ESAs) to establish a joint working group "to initiate a collective reflection on the ways of improving the current framework for cooperation between AML and prudential supervisors".

On 12 September 2018, the EC issued a communication on strengthening the Union framework for prudential and anti-money laundering supervision for financial institutions.

The EC indicates that fighting effectively against financial crime, including tax crime, needs a proper implementation of the new rules (including the Fifth AML Directive) and a stronger coordination between the different authorities.

In its communication, the EC sets out a strategy based on the analysis carried out by the joint working group. As part of the proposed strategy, the European Commission is proposing a number of short-term legislative and non-legislative initiatives, as well as a number of longer-term objectives.

In the short term, the EC observes that certain provisions in sectoral legislation, and in particular in the Capital Requirements Directive (CRD), may have an impact on AML matters. In this respect, the EC refers to the confidentiality regime in the CRD in combination with the absence of a clear obligation for the prudential supervisors to cooperate with the AML authorities and bodies.

The EC is proposing to amend CRD in two respects. Firstly, in the context of enhancing information exchange requirements, all relevant authorities and bodies that receive, analyse and process information should be explicitly covered by confidentiality waivers. Also, with respect to the duty of cooperation, relevant authorities should have the possibility to refer disagreements on cooperation to the EBA.

The EC is also proposing a number of measures aimed at strengthening supervisory convergence.

These measures include clarifying in more detail the European Banking Authority's (EBA) anti-money laundering-related tasks. As such it proposes that the EBA should carry out periodic independent reviews on anti-money laundering issues, with expert input from the proposed Anti-Money Laundering Standing Committee. Where a review reveals serious shortcomings, it is proposed that the EBA should inform the European Parliament, the Council and the Commission.

The EBA should also carry out regular risk assessment exercises to test strategies and resources in the context of anti-money laundering risks. Finally, the enforcement capacity of the EBA should be strengthened. It

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The number of offences included in the new AML directive.

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Effective AML policy and enforcement in EU Member States are essential for the overall soundness, integrity and reputation of the entire financial system

is proposed that the EBA should be able to request national supervisors to investigate cases where financial sector operators are alleged to have breached their obligations under the AML Directive and should under certain conditions be able to adopt decisions directly addressed to financial sector operators. The EC also proposes to reinforce cooperation with third-country authorities.

Proposed short-term non-legislative initiatives include the expansion of the Risk-Based Supervision Joint Guidelines to specify common procedures and methodologies, more stringent reviews of the activities of anti-money laundering authorities and a more proactive role for the EBA in the establishment of contacts with third-country authorities. Clarifying the division of tasks between the European Central Bank and the national competent authorities is also highlighted as a point of attention.

In the longer term, the debate on a central European AML authority is ongoing. While it is unlikely that such a body will be established before the next elections, it is clearly a continuing topic of debate.

The EC indicates that "in particular, transformation of the Anti-Money Laundering Directive into a Regulation, which would have the potential of setting a harmonised, directly applicable Union regulatory anti-money laundering framework should be considered". Indeed, differences in national implementation can still cause friction in the regulatory framework.

In addition, regarding the supervisory architecture, the communication indicates: "Different alternatives could also be envisaged in order to ensure high-quality and consistent anti-money laundering supervision, seamless information exchange and optimal cooperation between all relevant authorities in the Union. This may require conferring specific anti-money laundering supervisory tasks to a Union body".

Effective AML policy and enforcement in EU Member States are essential given the potential negative impact of shortcomings in AML enforcement within individual institutions and individual Member States on the overall soundness, integrity and reputation of the entire financial system.

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Clearing a path for EU firms to access UK platforms post-Brexit

Concerns that EU banks could lose access to UK clearing houses for derivatives transactions under a no-deal Brexit need addressing as a matter of urgency.

With less than four months to go until Brexit, the UK and EU have agreed a withdrawal agreement at a political level. However, if this agreement is not passed by the UK parliament, there is a risk that the UK could crash out of the bloc without a deal which could have a devastating impact on about £41 trillion worth of derivatives contracts.

That's because European banks could lose access to LCH, a unit of the London Stock Exchange (LSE), which clears about 90 percent of Euro-denominated interest-rate swaps.

Brexit will shatter the ecosystem for settling derivatives contracts that has been protected by pan-European regulations, such as MiFID and EMIR, which allow EEA firms to enjoy easy access to UK trading venues and central counterparties (CCPs) like LCH. Trading venues include regulated markets, multilateral trading facilities (MTFs) and organised trading facilities (OTFs).

MiFID grants regulated markets, such as the LSE and Germany's Frankfurt Stock Exchange, mutual access rights to participants across the EEA.

MiFID also gives MTF operators such as Eurex Repo in Germany, and OTF operators passporting rights, allowing them to provide their services across the EEA. EMIR allow CCPs, such as LCH and Germany's Eurex market, access rights to provide clearing services across the EEA.

Currently, most members of these trading venues and CCPs tend to be authorised investment firms or credit institutions because these types of entities possess the necessary resources and sophistication to engage in on-venue trading and clearing activities.

This existing regulatory system means trading venues and CCPs do not have to set up a fully capitalised entity in each EEA Member State in which they wish to operate in, thereby reducing the legal and regulatory burden. Supporting this framework are provisions that prevent individual Member States from putting in place arbitrary barriers to entry into their financial markets. Therefore, MiFID and EMIR create a single market across the EEA that allows trading venues and CCPs established in one Member State to provide trading and clearing services across the EEA.

The Brexit effect—a "third-country"

If the UK exits the EU on 29 March 2019 with no EU/UK reciprocal transitional period or other relevant arrangements in place, UK trading venues and CCPs will cease to be authorised or recognised entities under EU legislation and, as a result, will no longer benefit from market access and passporting rights prescribed under MiFID and EMIR.

After Brexit, UK trading venues will become so-called "third-country" firms. There are existing third-country frameworks under EU legislation, but these are not comprehensive whole market measures and are within the full discretion of EU institutions.

Under MiFIR "third-country" firms can register with the European Securities and Markets Authority (ESMA) in order to provide investment services across the EEA. But before any such registration can occur, the European Commission (EC) must have made an equivalence decision relating to the relevant third country. This process is detailed and time-consuming.

Recent examples of third-country equivalence tests in other areas

> **Brexit will shatter the ecosystem for settling derivatives contracts that has been protected by pan-European regulations, such as MiFID and EMIR**

90%
of Euro-denominated interest-rate swaps are cleared by LCH.

After Brexit UK trading venues will no longer benefit from mutual access and passporting rights under MiFID and will not be able to provide trading services into the EEA

of EU legislation demonstrate that this can take several years (e.g., in the derivatives sector). The outline political declaration of the future relationship between the EU and UK notes that both parties will commence equivalence assessments as soon as possible, endeavoring to conclude these before the end of June 2020. If there is a no deal Brexit, the UK will introduce a temporary permissions regime to mitigate the licensing risk for incoming firms. The EC has made indications that it may also introduce steps to mitigate against similar risks, particularly relating to clearing.

Any MiFIR equivalence decision would allow UK firms to provide investment services to non-retail clients across the EEA without having to incorporate a new legal entity. Importantly, this would cover trading venues, such as MTFs and OTFs, but would not cover the operators of regulated markets, as this activity does not fall within the definition of "investment services."

In the absence of an equivalence decision, UK trading venues need to consider whether the provision of their services to EEA firms would be regarded as an investment service or activity under MiFID or a regulated activity in each Member State of their EEA clients. As regulated markets would not benefit from any equivalence decision, they would need to consider the national licencing (or exemptions) in each relevant individual EEA Member State.

From a trading perspective, there are arguments that a non-EEA trading venue may not be performing an investment service or regulated activity in the EEA by just having members that are EEA firms. This often depends on number of factors, such as the nature of the trade, marketing activities of the venue and its physical presence in EEA. This is based on arguments that the characteristic place of performance of the venue's activities is outside the EEA. The interpretation of the characteristic place of performance ultimately comes down to the relevant EEA Member State's national interpretation of what lies within and outside the scope of its national licencing requirements.

After Brexit, as UK trading venues will no longer benefit from mutual access and passporting rights under MiFID, they will not be able to provide trading services into the EEA. Therefore, UK trading venues face a potential licencing risk if they continue to provide services to EEA members. This is because the provision of trading venue services to a member that is incorporated in an EEA Member State could be seen as providing such services into that Member State and within the scope of EU (and/or national) authorisation requirements.

UK trading venues are taking a number of steps to address market access issues. For example, the London Metal Exchange (LME)—a recognised investment exchange in the UK—has published details of its Brexit planning on its website. The LME is seeking regulatory licences or exemptions in EEA jurisdictions in which its members are located and is anticipating receiving licences or exemptions needed to provide access to EEA firms so they can continue trading on the LME. Bloomberg has expressed concerns around its ability to service EEA members from its UK MTF and has established a new entity in the Netherlands. It has also applied for authorisation under MiFID as an MTF in order to maintain access to EEA single market and service EEA members.

Without an EU/UK transitional period or EU Commission equivalence decision on UK trading venues (as well as something covering regulated markets), EEA firms are unlikely to be able to be members of the UK trading venue, unless the UK trading venue has itself obtained the relevant licences or exemptions from the particular EEA Member States.

If the relevant measures are not in place at the point of Brexit—or after any transitional period—EEA firms face being cut off from large pools of liquidity and potentially increased trading and hedging costs. UK trading venues will face limited access, if any, to EEA markets and a decreased client base, unless they establish an EEA authorised entity or obtain the relevant national licences/exemptions.

Where next for CCPs?

UK CCPs will become third-country CCPs after Brexit. Under EMIR, a CCP established in a third country may provide clearing services to clearing members or trading venues established in the EU only where that CCP is recognised by ESMA. This provision effectively prohibits non-EEA CCPs providing clearing services to EEA firms,

£41tn

worth of derivatives contracts could be impacted if the UK crashes out the EU without a standstill agreement.

unless they have ESMA recognition.

Post-Brexit, in order for UK CCPs to obtain recognition, the EC will need to adopt an implementing act in relation to the UK. For its part, the UK CCP must be appropriately authorised in the UK, there must be a cooperation agreement in place between ESMA and the UK regulators, and there must be equivalent anti-money laundering requirements in the UK. The UK CCPs are already authorised from a UK perspective, and there are equivalent anti-money laundering requirements in the UK. Therefore, whether UK CCPs will become recognised will be down to the EC and ESMA.

Until a UK CCP is recognised by the ESMA, it will no longer be able to provide services to EEA clearing members. Therefore, in respect of derivatives subject to the EU's mandatory clearing obligation (e.g., G4 interest-rate swaps), EEA clearing members will need to close out their positions with UK CCPs prior to Brexit and then open new positions with an authorised EEA, or third-country recognised CCP.

Without EU pre-emptive actions and decisions relating to recognition of UK CCPs at the point of Brexit, this will involve a huge repapering exercise that is unlikely to be completed before 29 March 2019. Further, EEA firms face potential market volatility given that a large part of the European market will be attempting do the same thing at the same time. There is also the issue around market capacity amid reports that for interest-rate swaps, Eurex—a possible destination for some EEA firms—only clears nine currencies compared to LCH's 21. For swaps denominated in Hungarian forints and Czech koruna, for example, EEA members currently using LCH would have to go to the US, where CME Clearing (a recognised CCP) matches LCH's currency sets.

For derivatives which are not subject to mandatory clearing, but which firms wish to put up for clearing, EEA firms can continue to access UK CCPs through UK clearing members. Where EEA firms are themselves acting for their own clients, they would then need to access UK CCPs through indirect clearing arrangements with the UK clearing members. Such arrangements would be permissible under EMIR, however, UK clearing members in such arrangements would have to consider their own EEA licencing position vis-à-vis their EEA clients or counterparties.

UK CCPs are taking a number of steps to mitigate market access issues for EEA firms. LME Clear has noted that it is possible for clients of an LME member to enter into a back-to-back exchange-traded derivative contract with its client under their terms of business. This contract is not a client contract under the LME rules, but the arrangement may qualify as an indirect clearing arrangement for the purposes of MiFIR. As LME will be facing a UK or non-EEA clearing member, it will not need to worry about the jurisdiction of the clearing member's client, so it will not be acting in breach of Article 25(1) of EMIR. There have been some indications that the EC is prepared to put in place time-limited equivalence for UK CCPs, in the event of a no deal Brexit to mitigate against the risks discussed above. This appears to be a more limited version of the UK's temporary permissions regime. Whilst this is welcomed and may provide some further breathing room for market participants, it does not deal with the

29 March 2019

Date of UK's departure from EU. The deadline could only be extended with a unanimous agreement of the UK and other 27 countries.

"Without an EU/UK transitional period or unilateral decisions made by the EU, the UK and EU face the prospect of significant market disruptions and widespread breaches of rules by large parts of the market

fundamental underlying issues on a long-term basis and may only serve to kick the can down the regulatory road.

EEA firms, UK venues and CCPs face a potentially daunting prospect. EEA firms may be forced off UK financial market infrastructure prior to Brexit so that these trading venues and CCPs do not breach EU laws—which will lead to loss of significant business. EEA firms also face the expensive and time-consuming prospect of trying to move billions (and, in some cases, trillions) of euros in notional values worth of derivatives positions from UK trading venues and CCPs to EEA (or certain non-EU) recognised trading venues or CCPs.

This is likely to have a substantial impact on volatility and pricing and may create market risks. Without an EU/UK transitional period (and in the longer term, agreement covering financial services) or unilateral decisions made by the EU, the UK and EU face the prospect of significant market disruptions and widespread breaches of rules by large parts of the market.

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